Mountain Hydro Nepal Limited: Ratings removed from 'Issuer Not Cooperating' category and placed on 'Watch with Developing Implications'

October 09, 2023

Summary of rating action:

Instrument (limits in NPR Million)	Previous rated amount	Current rated amount	Rating Action
Long-term loans; Fund based	3,255	2,838	[ICRANP] LBB&*; removed from 'Issuer Not Cooperating' category and placed on 'Watch with Developing Implications'
Short-term loans; Fund based	70	70	[ICRANP] A4&*; removed from 'Issuer Not Cooperating' category and placed on 'Watch with Developing Implications'
Total	**3,325**	**2,908**	

** The symbol '&' denotes rating on watch with developing implications. Please refer here for details on rating watch & its implications.*

Rating action

ICRA Nepal has placed the ratings of Mountain Hydro Nepal Limited (MHNL) under watch with developing implications, as indicated by long-term rating of **[ICRANP] LBB&** (pronounced ICRA NP L double B &) and short-term rating of **[ICRANP] A4&** (pronounced ICRA NP A four &). The ratings have also been removed from 'Issuer Not Cooperating' category.

Rationale

The rating watch with developing implications is mainly factoring the company's plans to continue the loan repayments as per the earlier schedule despite over two months' operational disturbances after the flash flood damages to its 22.1 MW hydropower project (HPP). While the consortium has agreed to adjust earlier prepayments from the repayments falling due in the upcoming quarter end (in lack of debt service reserve account - DSRA), the project is yet to undergo comprehensive repairs. Any unexpected operational disturbances during the same could accentuate the pressures on debt servicing. Further, the company's loss of profit (LOP) insurance policy had expired prior to the catastrophe (yet to be renewed), which increased liquidity pressures on MHNL, thus remaining a major rating concern. Additionally, funding sources and timeline for the sizeable pending repair works also remains to be seen along with the recovery timeline and quantum from the insurers. Given the sizeable provisions for repair costs in its FY2023 financials, the company's financial profile has moderated sharply with ~39% book value of equity eroded by losses in FY2023, thus leading to a high gearing of 4.3 times as of mid-July 2023. The ratings continue to remain constrained by the high hydrological risks in absence of a deemed generation clause in the power purchase agreement (PPA). This concern is aggravated by the instances of short supply penalties in recent years.

Nonetheless, the ratings consider the project's largely consistent generation trend at ~85% of contract energy during 11MFY2023. This, along with fixed borrowing rate of 8.5% has cushioned further impact on MHNL's financial profile, amid the recent spike in bank borrowing rates. Similarly, the ratings also continue to consider the low tariff and offtake risks amid the presence of a firm PPA with the Nepal Electricity Authority (NEA, the sole purchaser and distributor of electricity in Nepal) at pre-determined tariff rates and escalations. Going forward, MHNL's ability to swiftly complete the project's full-fledged repairs, timely/adequate management of funding gaps and receipt of insurance claim and thereafter the project's ability to achieve design operating parameters would remain the key rating drivers.

Key rating drivers

Credit strengths

Satisfactory generation and bank borrowings pegged at low rates cushioned the impact – The 22.1-MW Lower Hewa Khola Hydropower Project generated ~85% of contract energy during 11MFY2023 (last month's operations impacted by the flash floods in June 17, 2023), which is a slight drop as against the trend in earlier three years (~87%). Additionally, the project loans have fixed interest rate at 8.5% for 10 years ending on FY2030 which has somewhat lowered the impact of flash floods on the company's financial profile.

Low tariff and offtake risks – The tariff risk for the project is low amid presence of a 30-year PPA with NEA for its entire project capacity. The PPA for the initial 21.6-MW capacity has a "take or pay" clause, ensuring full offtake. Though the PPA for an additional 0.5-MW has 10% reserve margin clauses (applicable only to 0.5MW), this is not likely to have a meaningful impact on the company's revenue profile. The pre-defined tariff rates are NPR 4.8 per kWh for the wet season (mid-April to mid-December) and NPR 8.4 per kWh for the dry season. Over these base tariffs, there is a 3% annual escalation clause for five times in case of the initially contracted 21.6MW and eight annual escalations of 3% for the additional 0.5MW capacity. The project having been developed within six months of its RCOD, is eligible for all the tariff escalations.

Credit challenges

Project yet to undergo full-fledged repairs while debt repayment to continue as per schedule –The project was significantly damaged by the flash floods in June 17, 2023, for which the management had anticipated repair cost of NPR 460 million (as fully provisioned in the published financial highlights of FY2023, which is ~9 % of project cost). While the management has been able to resume project operations in a phase-wise manner (all three turbines were operational by September 02, 2023), these were based on temporary repairs and cost of ~NPR 90 million. The project is yet to undergo full-fledged repairs (planned for upcoming dry season) and any elongated operational disturbances during the same could further impact MHNL's financial profile. The company was yet to renew the LOP policy till the rating date, which accentuates these concerns. Further, the timely management of funding sources for the same and the extent/timeline of recovery from insurers will remain crucial. Amid this uncertain backdrop, the debt repayments have been agreed to continue as per earlier schedule. In lack of DSRA arrangement, the consortium has agreed to utilise prepayments so far (~NPR 148 million) to cover the repayment obligations falling due on mid-October 2023 (~NPR 119 million, including interest costs). Thereafter, the project's ability to achieve design operating parameters, without any major disturbances would remain critical in ensuring timely debt servicing in the following quarters, thus remaining a major monitorable.

Modest financial profile – With ~39% of equity eroded by losses in FY2023, the company's financial profile moderated sharply, a reflected in a high gearing ratio of 4.3 times as of mid-July 2023. Quantum of actual repair costs, recovery from insurers (for property damages) and incremental generation trend would remain crucial in determining the company's financial profile going forward.

Relatively higher project cost – The 22.1MW project was developed at a cost of ~NPR 222 million per MW and was funded in a debt-to-equity ratio of ~75:25. Given the relatively higher project cost and moderate plant load factor (PLF) of ~61%, the project's key return metrics and coverage ratios could remain modest amid a fixed tariff structure.

Hydrological risks – The lack of a deemed generation clause in the PPA exposes the project to high hydrological risks in case of any adverse river flow scenarios, for which no compensation would be received for such losses. This concern is further accentuated by the fact that the hydrology of the river is dependent on a rain-fed perennial source and the hydrological fluctuations have led to short supply penalties for most years so far (NPR 18 million in FY2023).

Links to the last rating rationale:

Rationale_Mountain Hydro_BLR Surveillance_September 2023

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to the applicable criteria:
[Corporate Credit Rating Methodology]

About the company

Incorporated in July 2005 as a private limited company, Mountain Hydro Nepal Limited (MHNL) was converted to public limited company in June 2016 to facilitate public participation. The company is operating a 22.1MW Lower Hewa Khola HPP in Panchthar District, Koshi Province of Nepal. The project is a run of the river (R-o-R) type and has been developed at 40% probability of exceedance (Q40). The project was commissioned on August 6, 2019 (as against the required COD of May 7, 2019) at a total cost of ~NPR 4,915 million, financed at a D:E ratio of 75:25. The paid-up capital of the company as of mid-July 2023 was NPR 1,250 million which was 80% promoter held while 20% was raised through an IPO. As on the same date, the major shareholders include Mr. Sitaram Timalsina and family members (~44%), M/s S.R. Power Investment Company Private Limited (~14%), Mr. Prakash Timilsina (~4%), among others.

Key Financial Indicators

Amount in NPR million	Audited			Provisional
	FY2020	FY2021	FY2022	FY2023
Operating Income (OI)	470	519	608	498
Profit after tax	-112	-5	70	-449
OPBDITA/OI (%)	90%	88%	82%	88%
ROCE (%)	11%	7%	8%	-5%
Total debt/Tangible net worth (TNW; times)	3.3	3.2	2.8	4.3
Total outsider liabilities/TNW (times)	3.4	3.3	2.9	5.1
Total Debt/OPBDITA (times)	8.3	7.6	6.5	6.8
Interest coverage (times)	1.1	1.4	1.9	1.7
DSCR (times)	1.1	1.3	1.3	-0.1
NWC/OI (%)	20%	17%	14%	-92%

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